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INTERNATIONAL ECONOMIC COMPARISONS

Summary of U.S. Economic Conditions

U.S. current account

The U.S. Department of Commerce reported that the deficit on U.S. current-account decreased to $40.5 billion in the first quarter of 1995, from $43.3 billion in the fourth quarter of 1994, despite an increase in the deficit on goods and services. A decrease in the deficit on investment income and lower net unilateral transfers more than offset the deficit on goods and services.

The deficit on goods and services increased to $30.0 billion in the first quarter, from $27.5 billion in the fourth. The deficit on merchandise trade widened by $1.6 billion, and the surplus on services decreased by $1.0 billion. The deficit on merchandise trade increased to $45.1 billion in the first quarter, from $43.5 billion in the fourth. Exports increased to $138.1 billion, from $133.9 billion. An increase in nonagricultural and, to a lesser degree, in agricultural exports accounted for most of the total export rise. Imports increased to $183.1 billion, from $177.4 billion. Nonpetroleum imports accounted for the bulk of import increase.

The surplus on services decreased to $15.0 billion in the first quarter from $16.0 billion in the fourth. Services receipts decreased to $50.8 billion, from $50.9 billion. The small decline was more than accounted for by decreases ~~in travel~~ and in other transportation categories. Services payments increased to $35.8 billion, from $34.9 billion. The rise was largely accounted for by increases in other transportation and in other private services categories.

Investment income

Income receipts on U.S. assets abroad increased more than U.S. income payments on foreign assets in the United States, leading to a decline in the deficit on investment income from $4.6 billion in the fourth quarter to $2.7 billion in the first quarter. Total income receipts increased to $42.5 billion in the first quarter, from $38.3 billion in the fourth, as both direct investment receipts and other private receipts rose substantially. Direct investment receipts were boosted by higher earnings, and other private receipts were boosted by relatively higher interest rates abroad. U.S. income payments on foreign assets in the United States increased to $45.2 billion, compared with an increase of $42.9 billion in the fourth quarter. Other private payments and U.S. Government payments both increased substantially in the first quarter over the previous quarter due to rising U.S. interest rates. Net unilateral transfers were $7.8 billion in the first quarter, compared with $11.2 billion in the fourth. The decrease was largely accounted for by a drop in U.S. Government grants, following large fourth-quarter disbursements to Israel.

Capital transactions

Net recorded U.S. capital inflows were $21.1 billion in the first quarter of 1995, compared with $29.5 billion in the fourth as acquisitions of foreign assets by U.S. residents increased substantially and acquisitions of U.S. assets by foreign residents changed slightly.

U.S. assets abroad

U.S. assets abroad increased by $64.0 billion in the first quarter of 1995, compared with an increase of $55.2 billion in the fourth quarter of 1994. Net U.S. purchases of foreign securities were $5.8 billion in the first quarter, down from $15.2 billion in the fourth. Net capital outflows for U.S. direct investment abroad increased $18.4 billion in the first quarter from an increase of $11.9 billion in the fourth. A step-up in reinvested earnings and an increase in net intercompany debt outflows to U.S. foreign affiliates over inflows from U.S. foreign affiliates accounted for the bulk of the capital outflow increase.

Foreign assets in the United States

Foreign assets in the United States increased by $85.1 billion in the first quarter of 1995, compared with an increase of $84.7 billion in the previous quarter. Net private foreign purchases of U.S. Treasury securities were a record $29.6 billion in the first quarter, up from $25.9 billion in the fourth. Net foreign purchases of U.S. Treasury securities from Western Europe and from Japan were sizable. Net foreign purchases of U.S. securities, other than U.S. Treasury securities, were $15.6 billion in the first quarter, up from $10.2 billion in the fourth.

Net capital inflows for foreign direct investment in the United States were $9.8 billion in the first quarter, down from $19.6 billion in the fourth. The decrease was accounted for by a shift from inflows to net intercompany debt outflows and by a decrease in net equity capital inflows. Reinvested earnings increased slightly.

Foreign official assets in the United States increased $21.4 billion in the first quarter, in contrast to a decrease of $0.4 billion in the fourth. Assets of industrial countries accounted for much of the increase, reflecting, in part, intervention purchases of U.S. dollars in exchange markets by foreign monetary authorities. Table 1 shows a summary of U.S. international transactions.

U.S. Economic Performance Relative to other Group of Seven members

Economic growth

U.S. real GDP—the output of goods and services produced in the United States measured in 1987 prices—grew at an annual rate of 0.5 percent in the second quarter following an increase of 2.7 percent in the first quarter of 1995. Real GDP increased 4.1 percent in 1994.

The annualized rate of real GDP growth in the first quarter of 1995 was 2.7 percent in the United Kingdom, 0.7 percent in Canada, 2.8 percent in France, 5.8 percent in Italy, and 0.3 percent in Japan. GDP real growth rate in the fourth quarter of 1994 was 3.0 percent in Germany.

Industrial production

U.S. industrial production gained 0.1 percent in June 1995 following declines of 0.1 percent in May and of 0.7 percent in April. The production of motor vehicles and parts and the output of other sectors remained sluggish. In June 1995, industrial production was 2.5 percent higher than a year ago. In the second quarter, industrial production fell 3.2 percent at an annual rate, with the decrease in output of motor vehicles and parts accounting for most of the decline. Capacity utilization contracted 0.2 percent to 83.5 percent in June 1995, following a decline of 0.4 in May, but was 3.3 percent higher than in June 1994. Capacity utilization in manufacturing fell in June by 0.3 percent to 82.7 percent but was 3.7 percent higher than a year ago.

Other Group of Seven (G-7) member countries reported the following growth rates of industrial production. For the year ending May 1995, Japan reported an increase of 5.9 percent, and the United Kingdom reported an increase of 1.4 percent. For the year ending April 1994, Italy reported an increase of 1.4 percent; Canada, an increase of 5.1 percent; and France, an increase of 2.3 percent. For the year ending March 1995, Germany reported a decrease of 0.3 percent.

Prices

The seasonally adjusted U.S. Consumer Price Index (CPI) rose 0.1 percent in June 1995, following a 0.3 percent increase in May. For the 12-month period ended in June 1995, the CPI-U increased by 3.1 percent.

During the 1-year period ending June 1995, prices increased 3.5 percent in the United Kingdom, 1.6 percent in France, 2.3 percent in Germany, and 5.8 percent in Italy. During the 1-year period ending May 1995, prices increased 2.9 percent in Canada and nil in Japan.

Employment

The U.S. unemployment rate remained unchanged at 5.6 percent for June 1995. Nonfarm payroll employment increased by 215,000, with the most noteworthy gains in the services and construction industries. Manufacturing employment, however, continued to shrink. Thus far in 1995, the unemployment rate has fluctuated between 5.4 and 5.8 percent.

The jobless rates for the major worker groups were as follows: adult men (4.8 percent), adult women (5.0 percent), teenagers (16.4 percent), whites (4.8 percent), blacks (10.6 percent), and Hispanics (9.0 percent). These are the same levels as those registered in May.

Table 1
Summary of U.S. international transactions, seasonally adjusted (credits +, debits -)
(Billion dollars)

Item	1993	1994	1994 Oct.-Dec.	1995 Jan.-Mar.
Current account:				
Exports of goods	456.8	502.5	133.9	138.1
Import of goods	-589.4	668.6	-177.4	-183.1
Balance on merchandise trade	-132.6	-166.1	- 43.5	- 45.1
Exports of services	187.7	198.7	50.9	50.8
Imports of services	-130.0	-138.8	-34.9	-35.8
Balance on services trade	57.8	59.9	16.0	15.0
Balance on goods & services	-74.8	-106.2	-27.5	-30.0
Income receipts on U.S. assets abroad	119.2	137.6	38.3	42.5
Direct investment receipts	61.6	67.7	18.7	20.9
Other private receipts	52.6	65.8	18.5	20.5
U.S. Govt. receipts	5.1	4.1	1.1	1.2
Income payments on foreign assets in the U.S.	-110.3	-146.9	-42.9	-45.2
Direct investment	-5.2	- 22.6	-7.3	-7.2
Other private payments	-63.4	- 77.3	-22.4	-23.8
U.S. Govt. payments	-41.6	- 47.0	-13.2	-14.2
Balance on investment income	8.9	9.3	- 4.6	- 2.7
Unilateral transfers, net	-34.1	- 35.8	-11.2	- 7.8
Balance on current account	-99.9	-151.3	-43.3	-40.5
Capital account:				
U.S. assets abroad, net (increase/ capital outflow -)	-184.6	-125.8	-55.2	-64.0
U.S. private assets, net	-182.9	-130.9	-56.3	-58.7
Direct investment	- 72.6	- 49.4	-11.9	-18.4
Foreign securities	-141.8	- 49.9	-15.2	- 5.8
Foreign assets in the U.S., net (increase/capital inflows +)	248.5	291.4	84.7	85.1
Foreign official assets, net	72.2	39.4	- .4	21.4
Other foreign assets	176.4	252.0	85.1	63.7
Direct investment	41.1	49.5	19.6	9.8
U.S. treasury securities	24.1	33.8	25.9	29.6
U.S. securities other than Treasury securities	79.9	58.6	10.2	15.6
Other	31.4	110.1	29.5	8.7
Statistical discrepancy	36.0	-14.3	13.7	19.4
Balance on capital account	99.9	151.3	43.3	40.5
Net capital inflows	63.9	165.5	29.5	21.1

Note.—Because of rounding and omitted items, figures might not add to totals.

Source: U.S. Department of Commerce, U.S. International Transactions, First Quarter, BEA 95-30.

Employment in manufacturing fell by 40,000 in June, the third consecutive decrease. Since March, manufacturing has lost 104,000 jobs. During June 1995, declines were widespread, with the largest job losses occurring in the apparel and transportation equipment industries.

The services industry added 114,000 jobs in June. Sizable increases occurred in amusement and recreation, health, engineering and management, and educational services. Employment in business services also expanded in June, but growth in the industry has slowed considerably since early this year, and employment in its help supply component has actually declined.

In other G-7 countries, unemployment in June 1995 was 8.3 percent in Germany and 9.6 percent in Canada. In May 1995, unemployment was 8.3 percent in the United Kingdom, 3.1 percent in Japan, and 11.6 percent in France. In April 1995, unemployment was 12.4 percent in Italy.

Forecasts

Forecasters expect real growth in the United States to average around 1.3 percent (annual rate) in the second quarter of 1995 and then to accelerate to an average of 2.3 percent (annual rate) in the following two quarters. Factors that may restrain growth in 1995 include the impact of high interest rates on housing and on consumer spending, the large inventory overhang, and the contractionary impact of the decline in government spending. Table 2 shows macroeconomic projections by six major forecasters for the U.S. economy from April 1995 to March 1996 and the simple average of these forecasts. Forecasts of all the

Table 2
Projected changes of selected U.S. economic indicators, by quarters, Apr. 95-Mar. 96

(Percent)

Period	Conference Board	E.I. Dupont	UCLA Business Forecasting Project	Merrill Lynch Capital Markets	Data Resources Inc. (D.R.I.)	Wharton WEFA Group	Mean of 6 forecasts
	GDP current dollars						
1995:							
Apr.-June	6.5	3.0	3.2	4.5	3.1	3.0	3.9
July-Sept.	7.2	4.4	4.2	5.2	3.1	4.7	4.7
Oct.-Dec.	7.6	5.6	4.1	5.1	2.7	5.1	5.0
1996:							
Jan.-Mar.	8.0	6.1	4.9	5.7	5.0	5.7	5.9
	GDP constant (1987) dollars						
1995:							
April-June	2.1	0.8	1.0	2.0	0.5	1.2	1.3
July-Sept.	4.7	1.8	1.7	2.5	1.1	1.9	2.3
Oct.-Dec.	4.7	2.7	1.8	2.4	0.5	2.2	2.4
1996:							
Jan.-Mar.	3.5	2.9	1.9	2.8	2.4	2.5	2.7
	GDP deflator index						
1995:							
April-June	4.3	2.2	2.2	2.5	2.6	1.8	2.6
July-Sept.	2.4	2.5	2.5	2.6	2.0	2.8	2.5
Oct.-Dec.	2.7	2.8	2.5	2.7	2.1	2.8	2.6
1996:							
Jan.-Mar.	4.4	3.1	3.0	2.8	2.5	3.1	3.1
	Unemployment, average rate						
1995:							
April-June	5.7	5.7	5.7	5.6	5.7	5.9	5.7
July-Sept.	5.4	5.6	6.0	5.7	5.8	6.1	5.8
Oct.-Dec.	5.2	5.6	6.2	5.8	5.8	6.2	5.8
1996:							
Jan.-Mar.	5.1	5.7	6.3	5.8	6.0	6.2	5.8

Note.—Except for the unemployment rate, percentage changes in the forecast represent annualized rates of change from preceding period. Quarterly data are seasonally adjusted. Date of forecasts: July 1995.

Source: Compiled from data provided by the Conference Board. Used with permission.

economic indicators, except unemployment, are presented as percentage changes over the preceding quarter, on an annualized basis. The forecasts of the unemployment rate are averages for the quarter.

The average of the forecasts points to an unemployment rate ranging between 5.7 and 5.8 percent in the remainder of 1995. Inflation (as measured by the GDP deflator) is expected to remain subdued at an average rate of about 2.6 to 3.1 percent in the three remaining quarters of 1995. The slow down in general economic activity during 1995 is expected to keep inflation down and unemployment high.

U.S. TRADE DEVELOPMENTS

The U.S. Department of Commerce reported that seasonally adjusted exports of goods and services of \$64.8 billion and imports of \$76.2 billion in May 1995 resulted in a goods and services trade deficit of \$11.4 billion, virtually the same as the April deficit. The May 1995 deficit was \$2.3 billion more than the deficit registered in May 1994 (\$9.1 billion) and was \$1.8 billion higher than the average monthly deficit registered during the previous 12 months (\$9.6 billion).

The May 1995 trade deficit on goods was \$16.5 billion, slightly lower than the April deficit. The May services surplus was \$5.1 billion, slightly lower than the April surplus.

The seasonally adjusted U.S. trade in goods and services in billions of dollars, as reported by the U.S. Department of Commerce, is shown in table 3. Nominal export changes and trade balances for specific major commodity sectors are shown in table 4. U.S. exports and imports of goods with major trading partners on a monthly and year-to-date basis are shown in table 5, and U.S. trade in services by major category is shown in table 6.

Table 3
U.S. trade in goods and services, seasonally adjusted, Apr.-May 95

(Billion dollars)

Item	Exports		Imports		Trade balance	
	May 95	Apr. 95	May 95	Apr. 95	May 95	Apr. 95
Trade in goods on BOP basis *(Current dollars)*:						
Including oil	47.8	46.9	64.2	63.5	-16.5	-16.5
Excluding oil	47.9	47.0	58.1	58.1	-10.2	-11.1
Trade in services *(Current dollars)*	17.0	17.0	12.0	11.9	5.1	5.1
Trade in goods and services *(Current dollars)*	64.8	64.0	76.2	75.4	-11.4	-11.4
Trade in goods on Census basis *(1987 dollars)*	46.6	45.5	59.6	59.6	-13.0	-14.1
Advanced-technology products (not seasonally adjusted)	11.0	11.1	9.8	9.2	1.2	1.9

Note.—Data on goods trade are presented on a Balance-of-Payments (BOP) basis that reflects adjustments for timing, coverage, and valuation of data compiled by the U.S. Census Bureau. The major adjustments on BOP basis exclude military trade but include nonmonetary gold transactions and estimates of inland freight in Canada and Mexico not included in the Census Bureau data.

Source: U.S. Department of Commerce News (FT 900), July 1995.

Table 4
Nominal U.S. exports and trade balances, of agriculture and specified manufacturing sectors, Jan. 1994-May 1995

Sector	Exports: Jan.-May 1995	Exports: May 1995	Change: Jan.-May 1995 over Jan.-May 1994	Change: May 1995 over Apr. 1995	Share of total, Jan.-May 1995	Trade balances, Jan.-May 1995
	Billion dollars		*Percent*			*Billion dollars*
ADP equipment & office machinery	13.7	2.7	15.1	3.8	5.8	-9.1
Airplanes	6.4	1.3	-28.1	-23.5	2.7	4.8
Airplane parts	4.1	.9	5.1	12.5	1.7	3.0
Electrical machinery	20.7	4.4	17.6	7.3	8.7	-7.4
General industrial machinery	9.9	2.1	15.1	10.5	4.2	-0.3
Iron & steel mill products	1.8	.4	28.6	0.0	0.8	-3.9
Inorganic chemicals	1.9	.4	26.7	0.0	0.8	0.0
Organic chemicals	6.7	1.3	34.0	-7.1	2.8	1.0
Power-generating machinery	8.8	2.0	4.8	17.6	3.7	0.1
Scientific instruments	7.5	1.5	11.9	0.0	3.2	2.9
Specialized industrial machinery	9.4	2.0	20.5	0.0	4.0	1.0
Telecommunications	7.5	1.5	25.0	7.1	3.2	-5.8
Textile yarns, fabrics and articles	3.0	.6	15.4	0.0	1.3	-1.2
Vehicle parts	10.0	2.1	17.6	10.5	4.2	1.3
Other manufactured goods[1]	12.8	2.8	16.4	7.7	5.4	-4.8
Manufactured exports not included above	59.6	12.7	13.1	6.7	25.1	-49.9
Total manufactures	183.8	38.7	13.1	4.9	77.3	-68.3
Agriculture	22.7	4.1	27.5	-6.8	9.5	10.0
Other exports not incl. above	31.3	6.8	28.8	7.9	13.2	-3.1
Total exports of goods	237.8	49.6	16.2	4.2	100.0	-61.4

[1] This is an official U.S. Department of Commerce commodity grouping.
Note.—Because of rounding, figures may not add to the totals shown.

Data are presented on a Census basis.

Source: *U.S. Department of Commerce News (FT 900)*, July 1995.

Table 5
U.S. exports and imports of goods with major trading partners, Jan.1994-May 1995
(Billion dollars)

Country/area	Exports May 95	Exports Jan.-May 95	Exports Jan.-May 94	Imports May. 95	Imports Jan.-May 95	Imports Jan.-May 94
North America	15.0	71.6	65.6	17.8	85.3	68.8
Canada	11.4	53.6	45.6	12.5	60.4	49.6
Mexico	3.6	18.0	20.1	5.2	24.9	19.2
Western Europe	11.7	56.0	49.4	12.7	59.0	51.0
European Union (EU)	10.5	51.3	44.9	11.4	53.5	46.8
Germany	1.8	9.1	8.0	3.1	14.6	12.4
European Free-Trade Association (EFTA)[1]	0.9	3.3	3.1	1.1	4.4	3.4
Former Soviet Union/Eastern Europe	0.5	2.1	2.2	0.6	3.2	2.1
Former Soviet Union	0.3	1.4	1.5	0.4	2.3	1.3
Russia	0.2	1.1	1.1	0.3	1.9	1.1
Pacific Rim Countries	14.5	71.4	58.2	23.8	113.1	97.5
Australia	0.9	4.4	3.6	0.3	1.4	1.2
China	0.8	4.6	3.7	3.7	16.2	12.9
Japan	5.0	25.4	21.3	10.5	52.4	46.2
NICs[2]	6.3	29.7	23.1	6.6	30.5	26.8
South/Central America	4.4	20.5	15.7	3.7	17.1	14.6
Argentina	0.3	1.8	1.9	0.2	0.7	0.6
Brazil	1.0	4.9	2.8	0.7	3.5	3.4
OPEC	1.8	8.1	7.5	3.2	14.2	11.3
Total	49.6	237.8	204.6	63.1	299.2	252.3

[1] EFTA includes Austria, Finland, Iceland, Liechtenstein, Norway, Sweden, and Switzerland.
[2] The newly industrializing countries (NICs) include Hong Kong, the Republic of Korea, Singapore, and Taiwan.
Note.—Country/area figures may not add to the totals shown because of rounding. Exports of certain grains, oilseeds and satellites are excluded from country/area exports but included in total export table. Also some countries are included in more than one area. Data are presented on a Census Bureau basis.

Source: *U.S. Department of Commerce News (FT 900)*, July 1995.

Table 6
Nominal U.S. exports and trade balances of services, by sectors, Jan. 1994-May 1995 seasonally adjusted

	Exports Jan.-May 95	Exports Jan.-May 94	Change Jan.-May 95 over Jan.-May 94	Trade balances Jan.-May 95	Trade balances Jan.-May 94
	Billion dollars		*Percent*	Billion dollars	
Travel	25.2	24.6	2.4	6.5	6.6
Passenger fares	7.5	7.1	5.6	2.0	1.9
Other transportation	11.5	10.3	11.7	-1.0	-1.0
Royalties and license fees	10.1	9.0	12.2	7.7	6.6
Other private services[1]	25.2	24.1	4.6	9.9	9.4
Transfers under U.S. military sales contracts	5.1	4.7	8.5	1.0	0.2
U.S. Govt. miscellaneous services	0.4	0.4	0	-0.8	-0.7
Total	85.0	80.2	6.0	25.3	23.0

[1] "Other private services" consists of transactions with affiliated and unaffiliated foreigners. These transactions include educational, financial, insurance, telecommunications, and such technical services as business, advertising, computer and data processing, and other information services, such as engineering, consulting, etc.
Note.—Services trade data are on a Balance-of-Payments (BOP) basis. Numbers may not add to totals because of seasonal adjustment and rounding.

Source: *U.S. Department of Commerce News (FT 900)*, July 1995.

INTERNATIONAL TRADE DEVELOPMENTS

Trans-Atlantic Ties To Be Strengthened

The United States-European Union (U.S.-EU) relationship has come to dominate the multilateral trading system and plays a key role in global commerce. Despite some notable disagreements over substance and tactics, the relationship supports sizeable flows of goods, capital, and ideas and exerts a decisive influence over world trade events. Yet, the end of the Cold War, the conclusion of the Uruguay Round, and the lure of fast-growing markets elsewhere have led some to worry that a sense of drift in U.S.-EU relations could inadvertently cause the overall relationship to fall into disrepair. Convinced that the two regions share a common destiny and a historic burden for exerting global leadership, the European Union (EU) and the United States have begun exploring means to deepen their partnership in the economic, political, and security realms. Trade and investment are key elements of the effort to formalize and reinvigorate the Transatlantic relationship.

U.S.-EU trade and investment is already considerable. In early April, the World Trade Organization (WTO) reported that, after netting out intra-EU trade, the United States and the EU together accounted for some 35 percent of global exports and 39 percent of global imports during 1994. Fourteen of the world's 30 leading importing countries in 1994 were in North America or the EU. According to Commerce Department data, the EU was the United States' third largest regional trading partner, after North America and the Pacific Rim. In 1994, the EU accounted for 20 percent of total U.S. exports, or $96.5 billion, and for nearly 17 percent of total U.S. imports, or $109.1 billion (see *IER Chartbook*, June 1995 for details). Investment flows are even more important. Europe accounts for some 61 percent of total foreign direct investment in the United States in 1993 and for 49 percent of total U.S. direct investment abroad, on a historial cost basis.

The impact of the United States and the EU on global trade policy is often decisive. The rapproachment of the two protagonists was largely responsible for the successful conclusion of the Uruguay Round in December 1993. At that time, it was agreed that negotiations on specific service sectors would continue. The United States and the EU have been the most influential participants in ongoing financial services negotiations. In late June, the negotiations suffered a major setback when the United States said that it was unwilling to extend future improvements in market access, such as those anticipated as a result of changes in the Glass-Steagall Act and in interstate banking legislation, unconditionally to other participants on a most-favored-nation (MFN) basis. Rather, the United States said, it will tie expansion of foreign financial service activity in the United States to the attainment of reciprocal access in home country markets. EU attempts to persuade participants to keep their latest offers on the table and apply them on an MFN basis until December 31, 1997 averted a complete breakdown in the sectoral negotiations and could buy time to convince a reluctant U.S. Congress of the efficacy of an MFN approach. U.S.-EU compromise is seen as vital to settling such other outstanding issues from the Round as telecommunciations services, steel, and shipping, as well as such "new" issues as trade and the environment, competition policy, and investment.

With sectoral irritants ranging from broadcast quotas to bananas and with ongoing efforts to resolve U.S. concerns over EU enlargement and product approval procedures, day-to-day U.S.-EU trade differences show little sign of abating in 1995. At a more fundamental level, the EU continues to lead the global call for a U.S. retreat from unilateral tactics to attain its market access goals. Yet a report issued by the EU Commission in early July detailing U.S. market access barriers notes that the Uruguay Round has largely settled some long-standing issues and created a more solid foundation for resolving others. In contrast to the situation with its North American and Pacific trading partners, meanwhile, U.S. economic ties with EU member states have been made easier by the EU's overarching competence in many aspects of commercial policy and the increasing realization of a single internal market for goods, capital, and people.

Leaders on both sides of the Atlantic have recently taken steps to define the overall U.S.-EU relationship and prepare it for future challenges. On June 14, senior officials from the United States and the EU were commissioned by President Clinton, EU Commission President Jacques Santer, and EU Council President Jacques Chirac with the development of a transatlantic agenda for the 21st Century. The group's report will cover economic, security, and political issues and will be considered by the two leaders during a summit tentatively scheduled for December 1995 in Madrid in accordance with the Trans-Atlantic Declaration, which calls for biannual summits. The decision came on the heels of a major speech by Secretary of State Warren Christopher signaling U.S. support for an intensification of U.S.-EU dialogue on key issues.

In late July, EU representatives were again in Washington. A transatlantic trade and investment initiative was among the topics touched upon in public comments made after a July 24 meeting by EU Commission Vice President Sir Leon Brittan with U.S. Trade Representative Kantor. The proposed initiative could be launched at the December summit. Among the possible elements of such an initiative are a joint study of a potential U.S.-EU free trade area, expansion of public procurement opportunities, progressive liberalization of other remaining barriers to trade and investment, and cooperative initiatives in third countries.

The joint efforts complement preparations now underway in both the EU and the United States. On April 27, the EU Commission announced that it had begun studying the feasibility of a U.S.-EU free trade area (FTA), commonly referred to as a Transatlantic Free Trade Area (TAFTA). Among other things, it will identify candidates for further tariff reduction, explore whether enhanced cooperation in such areas as competition policy, investment, and product approval would be more advantageous than a full-fledged free trade agreement (FTA), and evaluate whether a North American-EU FTA is preferable to a U.S.-EU FTA. In late July, EU Commission released a communication containing proposals for action in each major aspect of the U.S.-EU relationship. On May 22, United States Trade Representative Mickey Kantor announced a four-pronged initiative to deepen U.S.-EU ties. Its four key elements include (1) studying remaining barriers in such areas as services, investment, intellectual property, telecommunications, and agriculture, (2) launching an immediate phase-down of barriers in such areas as standards, investment, and financial services, (3) developing a modality for addressing remaining barriers, and (4) launching a Transatlantic Business Dialogue to serve as an early warning mechanism and to recommend a future course for U.S.-EU economic relations.

In addition to TAFTA, a common "economic space" that aligns key aspects of regulation in addition to full free trade has been floated. EU Commission President Jacques Santer has suggested that a deeper economic relationship may not be possible until a more stable international monetary order is constructed, and pointed to the econonomic and monetary union (EMU) as a building block for such a regime. At the most expansive end of the spectrum is the idea of a formal treaty or of a less formal declaration of principles to provide both a comprehensive context and the overall structure for the U.S.-EU relationship. Sir Leon Brittan has suggested that the U.S.-EU relationship may best be conducted within the auspices of a Transatlantic Treaty that would incorporate economic, security, and political elements.

Each of these more expansive approaches is recognized as being viable only in the medium to long term. The EU, in particular, will need to sort out internal decisionmaking issues in light of the expansion in its membership and areas of responsibility. These issues are to be addressed at a 1996 intergovernmental conference.

Leaders from Britain, Germany, and Canada have embraced a U.S.-EU trade initiative as a way of anchoring the U.S.-EU relationship in a post-Cold War environment, linking the EU to North American Free-Trade Agreement (NAFTA), and setting an example for future multilateral liberalization. Speaker of the U.S. House of Representatives Newt Gingrich and several U.S. opinion leaders have also expressed broad support for the idea.

TAFTA has also generated objections within the EU and lukewarm enthusiasm in the United States. U.S. sights appear firmly set on improving access to the rapidly growing markets of Latin America, Central and Eastern Europe, and Asia. The initial response to a request for comments on the Transatlantic Business Dialogue suggests that U.S. business places the resolution of outstanding market access issues at the top of the negotiating agenda. Many of the issues identified are technical in nature, arising out of the single market initiative, expansion of EU membership, and the transformation of markets in Central and Eastern Europe.

Meanwhile, TAFTA has fueled concern by developing countries about their being left out of the trading system's benefits, feeding into allegations that the emerging order is that of a "rich man's club," impervious to the needs and aspirations of lesser developed nations. As remarks by WTO Director General Renato Ruggerio suggest, TAFTA is considered by many to be more serious threat to the multilateral trade system than that posed by subregional integration within Europe, the Americas, or Asia. Some, notably Claude Barfield at the

American Enterprise Institute, have suggested that the United States would be in the unique position of having preferred access to the three major regional trading blocs through NAFTA, the Asia-Pacific Economic Cooperation (APEC) forum, and TAFTA. Others note that Europe is playing an increasingly pivotal role in shaping outcomes in such areas as financial services, the recent auto dispute with Japan, and China's WTO accession and wonder how its broker role will affect global affairs. Perhaps in response to these criticisms, EU Commission President Santer and Secretary of State Christopher have underlined their commitment to ensure that any arrangement be consistent with the WTO and not to place the developing countries at any disadvantage.

Given concerns about TAFTA's impact on the global trading system, difficulties in improving present levels of market access in such sensitive sectors as agriculture and textiles and "trade fatigue," some leaders have urged that, in the short-term, the two sides pursue more pragmatic and less ambitious means to fortify trade ties and deepen economic relations across the Atlantic. Indeed, a building block approach, incorporating, expanding, and perhaps putting a deadline on existing initiatives, seems to be a common theme in public statements by U.S. and EU officials. In addition to concrete steps that deliver tangible, near-term improvements, consultative mechanisms are likely to be improved and areas for multilateral cooperation identified.

Even so, both sides appear to agree that a fundamental rethinking of US-EU trade relations will lay the groundwork for intense and more fruitful economic cooperation among the world's richest and largest trading blocs. They also appear to agree that only a visionary and integrated approach will prepare them to meet future challenges.

MERCOSUR Averts Auto Collision

Less than one year since its inception as a customs union, the Southern Cone Common Market, or Mercosur, seems to have circumvented a major crisis with relative ease. At issue is a bilateral dispute on trade involving Argentina and Brazil, the bloc's largest trading partners and the only auto producers. With the Government of Brazil threatening imminent quotas for all its auto imports, Argentine officials had little choice but to raise objections to the proposal with serious consequences for its already struggling domestic economy.

The newest of the South American regional trade agreements, Mercosur, traces its origins to a 1987 bilateral integration accord between the Governments of Argentina and Brazil. Paraguay and Uruguay were assimilated into the accord in 1991. The trade provisions of Mercosur, a regional free-trade area by 1991 and the gradual introduction of a common tariff on products from outside the region, formally entered into force on January 1, 1995. Since it was first conceived, economic growth by the bloc countries has substantially increased and intra-Mercosur trade has grown at annual levels of up to 40 percent. Mercosur has become one of the Western Hemisphere's largest trading blocs in terms of GDP, ranking second to NAFTA.

On June 13, 1995, Brazilian President Fernando Cardoso issued a statement that many analysts claimed would lead to the first nail in the coffin of Mercosur. Effective immediately, he said, the total number of automobiles imported into Brazil until the end of 1995 must not exceed the number imported during the January 1-June 13, 1995 time period by more than 50 percent. In essence, auto imports were to be slashed in half. Additionally, by 1996, car producers in Brazil would be allowed to import only the same dollar amount as they export.

The main reason cited for this sudden shift in trade policy was to curb the rapidly increasing number of foreign cars on Brazilian roads. For the first 4 months of 1995, Brazil registered $1.7 billion in automotive imports, practically equal to the entire amount of auto imports during all of 1994. Moreover, Brazil is currently facing a merchandise trade deficit which grew to $3.5 billion between January and May of this year, compared to the surplus recorded in the past few years. Brazil hoped that the cap on auto imports would begin to restore its trade balance.

This announcement fell hard on Argentina, which is already facing a recession and 12-percent unemployment, largely because of economic problems that originated in Mexico. One of the primary repercussions of Mexico's "peso crisis" was the mass exodus of deposits from Argentine banks, totaling $8 billion, as global investors took closer stock of economic policies and performance throughout Latin America. Argentina implemented a variety of austerity measures to support the currency and secured IMF assistance.

Despite these figures, Argentine's automotive sector has continued to flourish and has remained the most consistent performer in the Argentine economy. Production has burgeoned from 94,986 vehicles in 1990 to 393,212 in 1994. However, domestic sales have plummeted, falling by 43 percent between January and April 1995. As a result, automobile manufacturers in Argentina felt an urgent need to maintain and expand their export markets, one in which Brazil plays a vital role. Argentina shipped

approximately 24,000 cars to Brazil during the first 6 months of this year, a dramatic increase considering that the total figure for 1994 was 34,000 auto exports to Brazil. The new system proposed by Brazil would have conceded only an additional 12,000 cars from Argentina for the remainder of 1995, whereas auto makers in Argentina had anticipated exporting at least 50,000 more.

Argentine authorities questioned the legality of the Brazilian action, citing provisions in the Mercosur arrangement. Under the Ouro Preto agreement, signed in December 1994, all parties are required to facilitate a single tariff scheme in the auto industry by 1999. Until that time, the agreement states, no country is allowed to initiate divergent unilateral measures.

The Brazilian announcement preceded a conference of the Mercosur nations by just 5 days. The World Economic Forum sponsored the meetings which took place in Sao Paulo, Brazil, on June 18-June 20, 1995. Those in attendance included the presidents of the four member nations, the leaders of Chile and Colombia, and the Secretary General of the Organization of American States (OAS). In addition, over 350 distinguished guests participated, including statesmen and entrepreneurs from Western Europe, the United States, and from Latin America. The participation of Argentine President, Carlos Menem, however, did not come without initial conciliatory actions on the auto issue by the Brazilian Government. In fact, Menem threatened, "there is no point in discussing Mercosur accords if they are not to be respected." According to Menem, President Cardoso had assured him that the measures would not be applicable to Mercosur countries. However, no official announcement to this end was made. Instead, both presidents issued a joint communique on June 19, 1995, stating that over the next 30 days, discussions would be held to remedy their differences over auto trade. In a statement to the media, shortly after the release of the communique, President Menem declared, "we have agreed to negotiate the question during a period of thirty days, but if, at the end of that time, there is no accord, then Mercosur rules must prevail and Argentina must not be penalized with quotas."

The Brazilian Government maintained that its decision to restrict the flow of auto imports was driven by a fear that its domestic industry would ultimately be crushed if conditions did not change. Argentina became a source of concern when the number of its vehicles began to substantially increase on the Brazilian market in comparison to previous years. In addition, many Brazilian governmental officials and car makers claimed that reciprocity was lacking from Argentina and that the arrangement agreed upon at Ouro Preto favored Argentine-made cars. Dorothea Werceck, the Minister of Industry and Commerce in Brazil argued that cars and car products made in Brazil's duty-free zone in Manau pay as much as 30 percent in tariffs when exported to Argentina while similar goods produced in Argentina's duty-free zone in Tierra del Fuego are tax-exempt in Brazil.

Auto imports have increasingly become a focal point of contention between Argentina and Brazil in light of a promised $3 billion dollar investment into the Mercosur region by several multinational auto companies over the next 5 years. Many of these foreign firms, including Ford, Toyota, and Renault, have indicated a preference in favor of Argentina. Dick Foster, editor of Brazil Watch, a policy-analysis publication, concurs with this choice. He states that Argentina "is a more user-friendly country in terms of foreign investment." In addition, many foreign parts suppliers are already established in Argentina. As a means to enhance its attractiveness relative to Argentina, the Brazilian Government plans to cut import duties from 18 percent to 2 percent on capital equipment, parts, components, and raw materials to those foreign auto firms willing to invest in and export from Brazil.

Thus far, discussions between the two countries, over Brazil's quotas, have taken place in a relatively calm atmosphere. Both sides have down-played the issue as a simple "misunderstanding." The Brazilian Finance Ministry has suggested that the new auto quota system could take shape as a 50 percent reduction in total imports from all sources, not specific to a supplier nation. The Finance Ministry also highlighted the relatively insignificant role Argentine autos played in terms of the overall amount imported between January and June 1995. Although Argentine exports to Brazil did increase, of the overall $1.8 billion worth of foreign vehicles imported into Brazil, only $63.3 million were of Argentine origin.

On July 5, 1995, the Argentine Economic Minister, Domingo Cavallo, announced that the proposed plan by the Brazilian Government to sanction autos was not to include those produced in Argentina. An agreement was signed on July 11, 1995, officially exempting Argentina from the auto quota with promises made by both sides that a unified tariff system for the automotive sector would be established for Mercosur as a whole. Consultations to this end are scheduled to commence later this year.

Conclusion

The Brazilian decision to cap auto imports also applies to vehicles originating from the United States. However, Brazil is not a primary U.S. export market for automobiles and, in 1994, accounted for only $286,215 in overall sales. Moreover, the U.S. auto industry has already gained a solid footing within

Mercosur via Argentina, and projects are underway for further expansion. General Motors has been producing pickup trucks in Cordoba since 1994 and plans an additional $1 billion investment in Santa Fe; Chrysler is in the process of building an $80 million Jeep Cherokee plant in Cordoba; and Ford will invest $1 billion in Pacheco in Buenos Aires Province.

Intra-Mercosur auto trade will continue to favor Argentina until the Mercosur countries harmonize their auto trade policies. Until such time, it will remain profitable for U.S. auto giants to favor Argentina as a hub for investment directed at production for the Mercosur market.

Late last month, however, the United States officially voiced concerns about the restraint on auto imports into Brazil at a meeting of the World Trade Organization's General Council in Geneva. According to Booth Gardner, deputy U.S. Trade Representative, the Clinton administration "continues to be concerned about the economic implications of these restrictions as well as the implications for the integrity of the WTO." Brazil submitted a petition to the WTO's Balance of Payments Committee, which has until October 13th of this year to approve or reject the Brazilian initiative. In the meantime, both the United States, the European Union, Japan, South Korea and Mexico have expressed a strong desire to begin immediate consultations with Brazil over the issue.

Mexico Raises Duties on Imports From Nonpartner Countries

On May 30, the Zedillo Administration announced in the *Diario Oficial* (Mexico's Federal Register) that it would raise import duties on apparel, footwear, and leather goods to 35 percent, their maximum level bound by the World Trade Organization (WTO). The average duty of the affected products was 20 percent before the new measure took effect on June 9 for footwear and leather goods and on June 13 for apparel and related products. The higher tariff rates apply to virtually the entire list of goods in chapters 61 through 64 of the *U.S. Harmonized Tariff Schedule* and to various categories in chapters 42 and 43.

Mexico's latest tariff action is seen by many to signal a reversal of the policies pursued by the two previous administrations—those of presidents de la Madrid and Salinas—both of which had followed a course of dismantling Mexico's protective tariff barriers. However, the current administration denies a break with past policies. When plans for raising these duties were first announced in early March this year, Herminio Blanco, Secretary of SECOFI (Mexico's Department of Commerce and Industrial Development) described the tariff hikes as instruments of "temporary protection."

The new tariff measure is limited in terms of the countries and products it applies to. The higher duties do not directly affect imports from countries with which Mexico has free-trade agreements, notably the United States and Canada—partners in NAFTA. Also exempt are imports from those countries with which Mexico concluded recent free-trade accords: Chile, Costa Rica, Bolivia, Colombia and Venezuela.

Being applicable to apparel, footwear, and leather products only, the new tariff measure apparently strives to protect primarily Mexico's labor-intensive industries. According to unofficial statements cited by Mexican trade officials, the major targets are low-end consumer goods— apparel from China and other Asian countries and footwear from these countries and Brazil. These products and countries played a major role in Mexico's widening trade deficit before the peso crisis of December 1994 (*IER*, April, 1995).

Efforts to stem the flood of imports began well before the peso crisis (*IER*, February 1993). However, until the recent tariff hike of the Zedillo Government, such efforts took mostly the form of nontariff actions, including new labeling requirements, safety and quality standards for imports, hampering entry of products on grounds of tax delinquency by the importer, and other administrative measures. For example, in August 1994, the Salinas administration imposed certificate-of-origin requirements on certain imports of nonpartner countries.

Aggressive antidumping action since 1993 has been another recent Mexican approach to reduce imports. Although SECOFI brought unfair pricing complaints against imports from many countries—including the United States, Brazil, Germany, Denmark, and certain Republics of the former Soviet Union—its most notable antidumping action was the imposition of steep compensatory duties on a wide range of cheap imports from China. A 1,105-percent duty on Chinese footwear, imposed back in 1993, virtually halted such imports, but triggered a flood of footwear from other Asian countries, some of which were suspected to have originated in China.

Although products made in the United States are not directly affected by Mexico's latest tariff hikes, those U.S. companies that depend heavily on Asian materials and fail to meet NAFTA's origin requirements will be required to pay the higher duties. Affected also are U.S. retailers (such as J.C. Penney, K-Mart, and Wal-Mart) and distributors operating in Mexico, some of whom source an important portion of their wares in Asian countries.

It has been argued on behalf of affected U.S. companies that the new tariff measure is unnecessary and that the loss of the peso's purchasing power is sufficient by itself to sharply reduce Mexican demand for imported consumer items and wipe out the country's merchandise trade deficit. Indeed, in May, Mexico posted its fourth consecutive monthly trade surplus, allowing the country to attain a surplus of $1.9 billion in January-May 1995. By comparison, in the same period of 1994, Mexico registered a trade deficit of $7.2 billion. Although 1995 imports declined in all product categories, including capital goods and intermediate goods, imports of consumer goods fell most.

Queue for EU Membership Continues To Lengthen

Although the European Union (EU) recently grew from 12 to 15 members when Austria, Sweden, and Finland joined on January 1, the number of serious candidates for membership continues to grow. On June 12, the three Baltic nations of Latvia, Lithuania, and Estonia signed Association Agreements (also known as Europe Agreements) with the EU, which formally place them on track for eventual EU accession. The Baltics join six Central and Eastern European countries (the CEECs); these countries, Hungary, Poland, the Czech Republic, Slovakia, Bulgaria, and Romania, hope to join the EU around the turn of the century. Slovenia and the EU initialled an Association Agreement on June 15 and await final signature. Furthermore, the EU Commission recently agreed that Malta and Cyprus, both EU applicants since 1990, should begin accession negotiations 6 months after the conclusion of the 1996 intergovernmental conference (IGC) on reforming the Maastricht Treaty.

Last July, the EU concluded bilateral free-trade agreements (FTAs) with each of the Baltic nations. These FTAs provided for the dismantling of all tariffs and quantitative restraints on industrial goods by January 1, 1995, although Latvia and Lithuania were granted transition periods. Trade in textiles is governed by specific provisions, and agriculture and fisheries products are subject to special restrictions. The FTAs also contain safeguard clauses and provisions addressing payments, competition rules, the gradual adjustment of state monopolies, customs cooperation, and the approximation (alignment) of laws concerning trade and customs matters (for example, dumping) with those of the EU. An infant industry clause permits special treatment of Baltic exports to the EU of goods made by newly established companies.

Negotiations to conclude Association Agreements soon followed. After only two rounds of negotiations, the Baltics signed the new agreements on June 12. In addition to the trade and commercial elements covered in the FTAs, the Association Agreements contain additional provisions on economic cooperation (for example, movement of workers, establishment of companies, provision of services, and liberalization of public procurement) including, for the first time, the prevention of illegal activities (for example, illegal immigration, corruption, traffic in waste and counterfeit products, drugs, and organized crime). Also, they contain political, cultural, and financial provisions to enable the countries to associate more closely with the EU. The agreements are modeled after those concluded with each of the CEECs, but provide for faster integration—the transition periods for trade in industrial goods end in 1999, at the latest.

With the signing of the Association Agreements, the Baltics have joined the CEECs in participating in the so-called preaccession strategy endorsed by the European Council in Essen, Germany, last December. To better prepare the associated countries for membership in the EU, the European Council agreed to a plan of action that includes preparation of a White Paper to assist associated countries in aligning their legislation with that of the EU internal market. This element of the strategy is supported by the implementation of policies to promote integration in other areas, such as infrastructure, trans-European networks, the environment, foreign and security affairs, justice and home affairs, as well as culture, education, and training. Furthermore, the preaccession strategy creates a more "structured relationship" between the associated countries and the EU to improve dialogue and consultations on matters of common interest.

The White Paper, an important component of the preaccession strategy, was prepared this spring and was recently approved by the European Council at the semi-annual summit in Cannes, France, June 26-27. The paper, which has no legal effect and is not considered part of the formal accession negotiations, is intended to act as a guide for operating under the requirements of the EU single market. It identifies the legislative measures in the internal market area that should be tackled first, describes administrative and technical structures required to properly implement and enforce the legislation, and outlines how EU technical assistance can be adapted and enhanced to best support the period of transition. The EU intends to meet soon with each of the associated countries to discuss how to achieve White Paper objectives. It will be up to each associated country to establish its own program for approximation of internal market legislation taking into account "its progress with economic reform and its sectoral economic priorities," according to the EU Commission.

The timeframe to conduct enlargement negotiations with the CEECs and other associated states has not yet been decided. At the Essen summit, the European Council said that accession negotiations could not begin until "the institutional conditions for ensuring the proper functioning of the Union [are] created at the 1996 intergovernmental conference...." Unlike the situation with Malta and Cyprus, where it has been agreed that accession negotiations will begin 6 months after the conclusion of the IGC, the schedule for the CEECs remains vague. EU leaders stress that the pace of enlargement will be governed by the applicants themselves, who set their own path and speed for integration. It is anticipated that most of the associated states could become members by the early part of the next century.

Four of the CEECs have already formally applied for EU membership—Hungary, Poland, and, more recently, Romania (June 22) and Slovakia (June 27). Membership requires acceptance of the entire *aquis communautaire*, the body of primary and secondary legislation making up the EU legislative and policy framework, subject to possible transition periods or temporary derogations. Achieving integration into the EU internal market, as outlined in the White Paper, is only one step towards meeting membership obligations.

USTR Initiates Section 301 Action Against Fuji Photo Film

On July 3, 1995, United States Trade Representative Mickey Kantor initiated a Section 301 unfair trade practice investigation of Japan's consumer film and photographic paper industry. The investigation came in response to a petition filed by Eastman Kodak on May 18 alleging that Fuji Photo Film Company, its distributors, and the Japanese Government colluded to keep foreign film producers out of Japan's $9.37 billion film and photographic paper market. *The Wall Street Journal* reported that Kodak Chief Executive George Fisher said the U.S. industry is now "one step closer to finally correcting years of anti-competitive behavior in Japan regarding consumer photographic film and paper."

Despite more than 20 years of effort and $750 million, Kodak officials claimed that they have only been able to capture between 7 to 9 percent of Japan's market, compared to 60 percent in the United States and 40 percent in the rest of the world. In Japan, Fuji dominates the film distribution system and accounts for over 70 percent of consumer film sales and 56 percent of photographic paper sales. The balance of Japan's consumer film market is divided between Kodak, Afga (Germany), and Konica (Japan). Kodak contends that, despite its lower prices and positive brand image, Kodak products are carried by only 15 percent of Japan's film retailers. Kodak claims to have lost $5.6 billion in sales since 1975 because of Fuji's anti-competitive trade practices.

In May of 1995, Dewey Ballantine issued a report on behalf of Kodak detailing Fuji's alleged "collusive and exclusionary sales practices" in Japan's consumer film and photographic paper market. The report maintains that, during the early 1970s, Fuji and the Japanese Government conspired to organize "exclusionary distribution channels that tied [Japan's] four dominant wholesalers and the estimated 280,000 film outlets in Japan into a web specifically designed to exclude foreign and competing domestic firms." Japan used high tariffs, quotas, and other import barriers to protect its domestic film industry from outside competition. Ballantine asserts that, despite intense pressure from the United States and the OECD, the Japanese Government refused to open up its film market for fear that it would be overwhelmed by cheaper imports. Although Japan introduced a "market-opening liberalization" program that eliminated import and investment restrictions by the mid-1970s, the report maintains that a "collusive web" was already in place that effectively relegated other Japanese film manufacturers and foreign competitors to the margins of Japan's film market.

Since 1976, according to Kodak, Fuji has preserved its exclusive distribution network by horizontal price fixing, by "operating a clandestine system" of cash rebates to retailers, and by threatening retaliation against any retailer who attempts to sell discounted Fuji film or lower-priced foreign film. Fuji uses four principal wholesalers, called kuyakuten, to distribute its film. According to Dewey Ballantine, the kuyakuten distribute 59 percent of Fuji's film directly to retailers, 33 percent to secondary wholesalers to retail outlets, and the remainder to primary film laboratories. The report claims that Fuji uses the kuyakuten to keep its prices excessively high and to lock out competition.

Dewey Ballantine also claims that Fuji's dominance over Japan's consumer film and photographic paper distribution routes makes Fuji essentially immune from meaningful opposition by either its foreign or domestic competitors. Fuji, according to Kodak, painstakingly monitors its distributors and retailers to prevent them from either lowering their prices or carrying another company's products without its knowledge. The *New York Times* reported that Kodak alleges that the Japanese Government allowed Fuji to create a "profit sanctuary" by permitting it to charge artificially high prices in

Japan to subsidize and finance its lower priced exports. According to Kodak, Fuji has amassed a $10 billion "war chest" that it uses to finance its exports. The "war chest," according to Kodak, gives Fuji an unfair advantage in international markets and allows it to offer prices less than those of its competitors. Industry sources report that Kodak is renewing its efforts in order to compete in the potentially lucrative digital imaging electronic photography market. Kodak is also increasing the intensity of its advertising, offering new products, and will sell private-brand film through Japanese supermarket chains for the first time.

On the other hand, the Japanese Government insists that its consumer film and photographic paper market is open to foreign participation. Fuji's managing director, Masayuki Muneyuki, was quoted by the *Washington Post* saying that "the film industry is one of the most intensely competitive in Japan" and that Fuji has "never forced wholesalers to sever their relationship with Kodak." Mr. Muneyuki also stated that "distributors and wholesalers have the right to choose which manufacturer they wanted to buy from." Japan's Ministry of International Trade and Industry reported that Japanese imports of consumer color film increased by 41.5 percent in 1994 as compared to 1993. The *Tokyo Shimbuyn* reported that Japan's four largest film distributors were "engaged in a keen price slashing war" during 1995.

Fuji publicly denounced Kodak's allegations, and the Japanese Government issued a statement announcing that it would not hold talks with USTR over a U.S. demand for greater access to Japan's consumer film and photographic paper market. Minister of Trade and Industry Kyutaro Hashimoto, according to the *Financial Times*, said "that the Government would not hold talks with the United States on photo film under the threat of sanctions." Government officials contend that Fuji's dominance of the Japanese market is strictly a reflection of consumer choice based on brand dominance and loyalty. It was reported in the *New York Times* that Japanese retailers reported that "Kodak's film is not particularly cheap and that when prices are the same, Japanese consumers simply prefer the better known Fuji." Fuji maintains that one reason why Kodak has not increased its market share is that it centers its marketing efforts only in Japan's largest cities, whereas Fuji maintains employees throughout Japan who assist photo shops with their sales, product promotion, advertising, and service.

Japanese Government officials pointed out that Kodak's position in the U.S. market is as dominant as Fuji's is in Japan's. They note that Kodak controls 71 percent of the U.S. market as compare to 12 percent for Fuji. Fuji officials acknowledge that Kodak has invested more than $750 million to gain greater access to Japan's market. They point out, however, that Fuji has invested more in the United States without a significant gain in market share and that Fuji has recently opened a $800 million facility in Greenwood, SC, dedicated to producing graphics arts materials, video tape products, photographic paper, and single-use cameras. Mr. Muneyuki charges that Kodak is simply attempting to shift the blame for its business blunders in Japan on to Fuji. He suggested that Kodak file a complaint with the Japan Fair Trade Commission if it truly believes that Fuji's retail practices were anti-competitive. *The Washington Times* reported that Fuji said it has used the same distributors for more than 50 years and "that they do not have exclusive sales rights, nor are they forbidden from handling competing products."

SPECIAL FOCUS

International Trade and the Role of Labor Standards

Introduction

During the last decade, the integration of the world economy, coupled with the growth of labor-intensive exports from developing countries, has focused attention on the linkages between trade and labor market conditions. The value of total U.S. trade has expanded by 130 percent since the early 1980s, from approximately $490 billion dollars in 1981 to more than one trillion dollars in 1994. Over this time period, the growth in real compensation for the average U.S. worker has been declining. The average wage differential between skilled and unskilled workers has also widened considerably. In 1993, the average male worker with a high school education earned 70 percent less than a similar worker with a college education; in 1979, this earning gap was only 30 percent.

The concurrence of these trade and labor market phenomena has generated concern about trade policies, worker welfare, and living standards in both industrialized and developing countries. The central questions are whether developing countries are using repressive worker practices to promote their exports and whether workers in countries with better labor standards, such as the United States, are being adversely affected through trade with developing countries that have lower labor standards.

Labor Standards, Trade, and Export Competitiveness

Are developing countries suppressing labor rights in order to reduce production costs and promote exports? Ten developing countries—Singapore, Hong Kong, Mexico, South Korea, Malaysia, Thailand, the Philippines, China, Indonesia, and India—together accounted for only 26.5 percent of U.S. imports in 1994, while five industrialized countries—Japan, Canada, Germany, the United Kingdom, and France—accounted for almost double this share, or 48.5 percent. However, the growth rates of U.S. imports from these developing countries over the past decade have been significant. U.S. imports from Singapore, Thailand, Malaysia and China each grew at an annual rate of more than 15 percent, a rate almost double that of U.S. imports from Japan—the fastest growing industrialized country supplier. In addition, U.S. imports from Mexico, South Korea, the Philippines, and India grew at rates comparable to or faster than imports from any of the industrialized countries.

A detailed examination of the export patterns of these ten developing countries, their labor standards, foreign direct investment flows, and wage trends indicates that this export success is not based on unfair advantages due to the lack of core labor standards. Specifically the data show that

- Sectors typically identified as having egregious labor conditions do not occupy the only or even the primary share of these countries' exports.
- Comparisons across more export-oriented and less export-oriented sectors indicate that core labor standards are often lower in less export-oriented or nontraded sectors, such as agriculture and services.
- Similarly, within an export-oriented sector, labor conditions in firms more involved in exporting are either similar to or better than those in firms that are less involved in exporting.
- Changes in technology and the structure of international trade are leading developing countries to compete in a race upward in terms of product quality rather than in a race downward with respect to price.
- U.S. foreign direct investment is not typically concentrated in countries or industries with poor labor standards.
- Wages and working conditions in developing countries have been exhibiting positive trends. In general, these have been in line with productivity changes.

Labor Standards and Export Industries

Inadequate labor standards in developing countries have many different forms. Some of the more common and perhaps most troubling include children knotting rugs for 10 or 12 hours a day and women making

textiles or toys in factories locked from the outside. Typically, the images are of labor-intensive production in manufacturing industries—the exact type of production where many developing countries have experienced large growth rates in the last decade. Industries that are most often identified as particularly egregious with respect to labor standards include textiles, carpets, certain leather items, garments, footwear, toys and wood furniture. These industries belong to two major SITC categories: SITC 6, which includes textiles, carpets, and certain leather item products and SITC 8, which includes garments, footwear, toys, and wood furniture. Other industries identified also as problematic, especially in terms of child labor, include gem stone polishing, fireworks, glassware, gold mining, and certain brass items. These activities are more dispersed and represent small shares of several major SITC categories.

Are exports from developing countries concentrated in sectors known to have poor labor standards? Data on exports by SITC sectors indicate that SITC 6 and SITC 8 do not occupy the only or even the primary share of these countries' exports. For Singapore, Mexico, South Korea, and Malaysia, nearly half or more than half of the export share is accounted for by products from the machines and transport equipment sector (SITC 7). In Hong Kong, Thailand, the Philippines, and China, SITC 7 represents approximately 20 percent or more of total exports and occupies one of the top three positions in exports. Exports of mineral fuels (SITC 3) are also important for Singapore, Mexico, Malaysia and Indonesia. Finally, for Thailand and India, the export of food and live animals (SITC 0) is significant, representing third place with export shares of 21 and 15 percent, respectively.

Despite the importance of exports from such sectors as SITC 7, SITC 3 and SITC 0, exports from the two problem sectors—SITC 8 and SITC 6—do represent a notable share, and they are within the top five export sectors for all of the countries.[1] If these export-oriented sectors are receiving special cost advantages through low core labor standards, labor standards should be lower in these sectors than in less export-oriented sectors. Comparisons across sectors, however, suggest that in many cases, labor standards are lower in less export-oriented or nontraded sectors, such as agriculture and services.

The animal and vegetable oil, fat, etc. sector (SITC 4), the beverages and tobacco sector (SITC 1), the crude materials etc. sector (SITC 2), and the food and live animals sector (SITC 0) occupy much smaller export shares than SITC 6 or SITC 8 in these countries. Production in agricultural and service industries such as these usually takes place on a small scale and much of this activity occurs in the informal sector of the economy. Information on worker rights is usually less available and less likely to be implemented or enforced in these situations. While workers may have other means to assert their rights in these sectors (i.e. through community based practices), they will typically not have access to the legislated rights of freedom of association and collective bargaining present in more formally organized manufacturing sectors. Child labor is also likely to be more prevalent. According to a survey by the International Labour Organization (ILO), 77 percent of economically active children under the age of 15 work in agriculture, hunting, forestry, and fishing.[2] Other common forms of child labor in nontraded services include domestic work, shoe shining, newspaper selling, garbage collecting, and prostitution.[3]

Sectors with U.S. foreign direct investment (FDI) often represent sectors with a higher proportion of more export-oriented firms in developing countries. Information on U.S.-invested sectors indicates that working conditions in these sectors tend to be superior to those in non U.S.-invested sectors. According to the State Department's *Country Reports on Economic Policy and Trade Practices* (1995), working conditions in Singapore's U.S.-invested sectors are similar to those in other sectors. However, in South Korea "working conditions at U.S. owned plants are for the most part better than at Korean plants." Similarly in Malaysia, working conditions in the two sectors with U.S. investment, petroleum and electronics, are considered to be excellent, and, in the electronics sector, "wages and benefits are among the best in Malaysian manufacturing." In Thailand, workers in sectors with U.S. FDI, particularly those working in U.S.-owned firms, have a higher unionization rate,

[1] Due to the unavailability of information, this discussion implicitly assumes that all activity within these two sectors involves the production of goods associated with poor labor conditions *and* that all of the production of these goods takes place under poor labor conditions. Despite this, data on the export of knotted carpets from India and China indicates that the share of these products in category SITC 6 exports, and thus the share of these products in total exports, is small for both countries. In addition, even though India has been identified as using a significant amount of child labor in rug production, the value of similar exports from China is almost three times as large.

[2] This is based on 1990 data from 19 countries. See International Labour Organization, *Bulletin of Labour Statistics* (Geneva: International Labour Office, 1993-3).

[3] See International Labour Organization, *World Labor Report (5)* (Geneva and Washington DC: International Labour Office, 1992); U.S. Department of Labor, *By the Sweat and Toil of Children: The Use of Child Labor in U.S. Imports* (Washington DC: Bureau of International Labor Affairs, 1994); and Christiaan Grootaert and Ravi Kanbur, "Child Labor," background paper, *World Development Report* (Washington DC: World Bank, 1995).

higher wages and benefits, and better health and safety standards than those of the average Thai worker. Multinationals in the Philippines, Indonesia, and India, generally apply internationally accepted labor standards in their firms. Finally, in China, "worker rights practices do not appear to vary substantially among sectors. In general, safety standards are higher in U.S. invested companies" and "there are no confirmed reports of child labor in the special economic zones or foreign invested sectors."

Although U.S. investment abroad is not always in sectors with average or above average labor standards and U.S. owned firms do not always provide superior working conditions, this is more often the common practice rather than the exception. In many cases, interactions between U.S. firms and countries with lower labor standards lead to enhanced labor standards in those countries. Thus, foreign direct investment appears to be a useful vehicle for the attainment of internationally accepted labor standards abroad.

Patterns of Export Behavior

Traditionally, developing countries have succeeded in exporting by competing for market share primarily through low prices. However, in the last decade, these countries have moved rapidly toward competing through quality upgrading and the development of variety or special product features. Important factors contributing to this trend are recent developments in technology and technology transfer and the changing structure of international trade.

The impact of incorporating technological improvements (or new technologies) into the production process has important implications for the level of core labor standards. Changes in the production process can have both direct and indirect effects on working conditions through the following channels: (1) the improved technology may require workers to receive more training which provides them with additional skills and thus more bargaining power, (2) the technology may eliminate or ease a labor-intensive procedure that was previously performed under suboptimal conditions,[4] and (3) the exchange of technological information with firms abroad may open the domestic firm to global public scrutiny and may also provide workers with information about conditions abroad.

The United States plays an important role in technology transfer to many developing countries through its foreign direct investment. While the long run impact of such investment is likely to be positive, it is important to examine the short run effects and determine whether an inordinate amount of U.S. investment is going to industries or countries that are considered to be problematic in terms of core labor standards. Data on U.S. FDI indicates that, at present, the percentage of investment in the developing countries is substantially below that in the industrialized countries considered here. In addition, a comparison across these developing countries suggests that a strong association between U.S. FDI and poor labor standards does not exist. Overall, as noted above, labor conditions in U.S.-invested sectors are similar to or better than those in the rest of the economy. In addition, while U.S. investment in the manufacturing sector is significant, more disaggregated data shows that, within manufacturing, U.S. investment is not concentrated only in labor-intensive production.

Data on growth rates of U.S. FDI from 1981-1993 suggest the following categorization by total investment for the developing countries considered here: High growth countries were Thailand, Singapore, South Korea, and Hong Kong; the middle growth countries were Indonesia, Malaysia, Mexico and India; and the Philippines was a low growth country. For manufacturing investment, the pattern was as follows: High growth countries were Thailand, Singapore, South Korea, Hong Kong, and Malaysia; middle growth countries were Mexico and the Philippians; and the low growth countries were Indonesia and India.

A classification of these countries based on their observance of two core labor standards is provided by the OECD.[5] The information suggests that with respect to the practice of freedom of association, Hong Kong and India have significant restrictions. However, in South Korea, the Philippines, Singapore, Thailand and Mexico, freedom of association is even more severely curtailed. Finally, in China and Indonesia, the right to unionize is in effect nonexistent. Regarding child labor practices, the information indicates that enforcement is adequate in Mexico, China, South Korea, Malaysia and Singapore. Some problems exist in Hong Kong, and extensive problems exist in the Philippines, India, Thailand and Indonesia.

Is U.S. FDI largely going to countries with poor core labor standards? Comparisons between the patterns of U.S. FDI and this information on core labor standards suggest the following: Hong Kong, which is relatively "good" with respect to both labor standards, is an important recipient of U.S. FDI in manufacturing. Conversely, Indonesia, a relatively "bad" country, is not significant in either the share or growth of U.S. FDI in manufacturing. Mexico has become a larger

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[4] Examples of this include the use of child labor to perform tasks that require attention to detail or jobs for which adults are not substitutable such as sweeping chimneys, weaving carpets with small knots, or working in mines.

[5] Organization for Economic Co-operation and Development, "Trade and Labor Standards," *Mimeo*, 1995.

recipient of U.S. FDI in the last few years. This is primarily due to NAFTA which has directly and indirectly had a positive effect on labor conditions in Mexico. Finally, despite its relatively poor labor conditions, India has not attracted a significant amount of U.S. FDI. While explicit distinctions for the other countries are not feasible, this evidence suggests that a strong positive association between U.S. FDI and poor labor standards does not exist.

An examination of U.S. FDI across sectors rather than countries indicates that a majority of U.S. investment is in the manufacturing sector of these developing countries. If U.S. investment is being drawn to manufacturing because of the presence of low core labor standards, investment within the manufacturing sector should be relatively concentrated in labor-intensive production. Disaggregated data on U.S. FDI in manufacturing indicate that U.S. investment is not highly concentrated in more labor-intensive production, but is instead prevalent in the following: food and kindred products, chemicals and allied products, and the output of other manufacturing products.

Firm Objectives and Worker Welfare

While competition requires cutting labor costs and promoting technological change, these cannot be done without consideration of labor productivity, and therefore, of worker welfare. In the past decade, many developing countries have been maintaining or increasing their labor productivity. If firms in these developing countries are gaining an advantage through lower core labor standards, the data should exhibit a pattern of increased exports, improved labor productivity and constant or slow growth in worker benefits.

Macroeconomic data for the manufacturing sector shows that, in many developing countries, real earnings per employee have increased significantly over time (table 7). During the 1980s, Singapore, Hong Kong, South Korea, Thailand, the Philippines, and India all experienced growth rates in earning per capita at or more than 5 percent. Data on real output per employee indicate that labor productivity increased significantly in several Asian countries during the 1980s (table 8). Comparisons between the data on earnings and output for the same countries show that, among such industrialized countries as Japan and France, output per worker grew slightly ahead of earnings per worker. In contrast, in Singapore, South Korea, Thailand and the Philippines, growth in real earnings per employee outpaced growth in output per employee. This indicates that, at the aggregate level, workers in these developing countries did receive compensation for their contribution to the countries' economic growth.

A parallel comparison between productivity and returns to labor at a disaggregated level shows a similar pattern. Data on value added and wages for detailed textile sectors by country indicate that, although this sector is generally associated with poor labor conditions, average real wages grew at comparable or faster rates than average real value added. Similarly, for countries with declining value added, such as the Philippines, Indonesia, and India, wages generally fell at a comparable or slower rate. Despite the paucity of data, it is possible to conclude that, in spite of low labor standards, workers in these developing countries generally received suitable compensation for their labor.

Assuming that firms have identified and are providing workers with the lowest level of labor conditions necessary to elicit satisfactory production, their ability to sustain this practice depends on a number of factors, many of which are beyond their control. These include the firm's power in the labor market, the overall level of worker mobility, the level of government and private involvement in social welfare, and the firm's sales market.

The firm's labor market power depends highly on the availability of surplus labor and the lack of opportunities facing workers. The tremendous export growth of the Asian NICs has been accompanied by high rates of GDP growth. This economic growth has increased job opportunities in manufacturing and also provided the labor force with alternative opportunities such as improved access to education and training. Those countries at the forefront of this growth path are now experiencing labor shortage problems. Thus, their ability to maintain poor labor standards is being curtailed. In addition, competition from succeeding countries has led to structural adjustments in production away from labor-intensive manufacturing toward capital and skill intensive output. This has further reduced the firm's usage of low cost labor and thus its ability to sustain poor labor standards. In some of these countries, government intervention has helped preserve control over the labor market in the short run. However, over time, the government and private firms have either fostered the improvement of labor standards or been forced to reform their labor policies by workers and other supporting groups.[6]

[6] Linda Lim and Jong-il You discuss historical wage controls, repressive labor market policies and current policies in South Korea and Singapore, respectively, (U.S. Department of Labor, *Labor Standards and Development in the Global Economy* (Washington DC: Bureau of International Labor Affairs, 1990).

Table 7
Index of Manufacturing Real Earnings per Employee (1987=100)

Country	1981	1990	1991	1992	Annual Growth Rate 1981-90
	(Percent)				
Canada	99	101	99	101	0.1
Japan	90	108	109	105	2.0
United Kingdom	84	105	104	105	2.4
France	92	107	110	111	1.6
Singapore	74	120	126	122	5.5
Hong Kong	74	113	113	114	4.9
Mexico	151	110	116	103	-3.5
South Korea	68	144	145	148	8.8
Malaysia	78	99	103	105	2.7
Thailand	67	116	([1])	([1])	6.3
Philippines	71	116	131	([1])	5.7
India	80	115	([1])	([1])	4.1

[1] Data not available.
Source: World Bank, *World Tables*, 1995.

Table 8
Index of Manufacturing Real Output per Employee (1987=100)

Country	1981	1990	1991	1992	Annual Growth Rate 1981-90
					(Percent)
Japan	91	126	130	([1])	3.6
France	97	114	114	([1])	1.8
Singapore	91	111	111	115	2.2
Mexico	85	118	122	125	3.8
South Korea	68	139	148	([1])	8.3
Thailand	93	109	([1])	([1])	1.8
Philippines	82	105	119	([1])	2.7
China	54	129	143	([1])	10.2
Indonesia	64	121	122	([1])	7.3
India	67	123	([1])	([1])	6.9

[1] Data not available.
Source: World Bank, *World Tables*, 1995.

U.S. Imports from Developing Countries, Labor Standards, and Domestic U.S. Conditions

Irrespective of whether labor standards are being purposefully suppressed or not, does trade between the United States and developing countries with lower labor standards have an adverse impact on U.S. employment and wages? Due to the difficulty in distinguishing between production based on such factors as natural comparative advantage and that based on the unfair suppression of worker rights, the subsequent discussion assumes that all imports from certain industries are produced under poor labor conditions. Despite this assumption, data on imports, employment, and wages in the United States indicate that the aggregate and sectoral effects on U.S. employment and wages are relatively small. Specifically,

- At the aggregate level, the impact of imports from these developing countries is small relative to imports from industrialized countries.
- Countries with lower labor standards do not exhibit higher rates of import penetration than countries with relatively higher labor standards.
- Imports from these developing countries do not appear to have larger displacement effects on U.S. employment and wages in sectors associated with poor labor standards relative to other sectors.

Aggregate Trade and Import Penetration

In 1994, ten major developing countries accounted for only 26.5 percent of total U.S. imports, approximately one-half the share represented by five industrialized countries. Even if exports from all ten developing countries are assumed to be based on equally poor labor standards, their aggregate impact on the U.S. economy is still relatively small. However, as discussed earlier, many of these countries have experienced significant growth rates over the past decade. Extending each country's average annual growth rate from 1981-94 to 1995-2000 indicates that the U.S. import share occupied by these ten developing countries will rise significantly in the next 5 years from 26.5 to 41.8 percent. Nonetheless, their share will still be less than the 51.1 percent share occupied by the five industrialized countries—Japan, Canada, Germany, the United Kingdom, and France.

If poor labor standards are an important basis for developing country exports, countries with lower labor standards should exhibit higher rates of import penetration. A comparison of relative import growth rates with information on freedom of association and child labor practices indicates that, in addition to not being attractive sites for U.S. FDI, countries with poor labor standards do not perform better in the U.S. market than countries that observe these core labor standards.

If lower labor standards were an advantage in exporting, the Philippines should perform better than Mexico and India in the U.S. market because of its worse labor conditions. However, the Philippines' share of U.S. imports grew at a considerably slower rate than both of these countries' shares during 1981-94. Indonesia, which should also benefit from its lower labor standards actually experienced an average annual growth rate of less than 1 percent. Although it is not possible to say that no relationship exists, the data suggest that poor labor standards are not a useful predictor of U.S. import shares.

Impact on U.S. Employment and Wages

If imports in sectors associated with poor labor standards abroad are providing developing countries with an unfair trade advantage, U.S. employment and wages in these sectors should exhibit relatively larger declines. Examination of sectoral level data on U.S. employment and wages for the periods 1981 and 1991-1994 suggests that some sectors did experience significant declines in both employment and wages. However, these changes cannot be distinctly linked to the import of products associated with poor labor standards, and the overall effects on the economy are relatively small.

Employment of U.S. production workers in manufacturing decreased at an annual rate of approximately 1 percent during the 1980s. However, the carpets and rugs sector (SIC 227), which more closely represents a problematic sector with respect to core labor standards, actually showed an increase in employment. Although two other sectors similarly associated with poor core labor standards, wood household furniture (SIC 2511) and toys and sporting goods (SIC 394), exhibited declines of approximately 1 percent, they accounted for only .8 and .6 percent of manufacturing employment, respectively, in 1981. Moreover, they maintained their relative shares over time, representing .8 and .6 percent, respectively, of manufacturing employment in 1994. Both sectors also

exhibited positive employment growth during the 1991-94 period.

The four other major sectors associated with poor core labor standards, textile mill products (SIC 22), apparel and other textile products (SIC 23), footwear except rubber (SIC 314) and handbags, et. al. (SIC 317), all exhibited employment declines larger than the decline for manufacturing as a whole. Of these sectors, the two with the greatest declines, footwear and handbags, et. al., represent an extremely small share of total manufacturing employment. Even at the beginning of the 1980s, each of these sectors accounted for less than 1 percent of manufacturing employment, approximately .9 and .2 percent, respectively. The employment declines in the textile (SIC 22) and apparel (SIC 23) sectors, however, were double the rate for manufacturing as a whole. These sectors also represent relatively large shares of manufacturing employment. However, the growth of apparel imports is significantly below the growth in imports in a number of other sectors and is not unusually high relative to other associated sectors.

A similar examination of U.S. wage data also indicates that sectors in which imports are commonly associated with poor core labor standards did not experience any undue downward pressure. While manufacturing wages fell during the 1980s, wages in textiles (SIC 22) and wood household furniture (SIC 2511) actually rose slightly. In addition, wage declines in carpets and rugs (SIC 227), footwear (SIC 314), and toys (SIC 394) were all less than half the decline in wages for manufacturing as a whole. However, apparel (SIC 23) and handbags, et. al. (SIC 317) experienced significant declines in wages. The wage decreases in apparel, the sector with the most employment, and in handbags, the one with the least employment, suggest that imports did not have a disproportionately negative effect only on wages in more labor-intensive industries.

Policy Implementation of Labor Standards

While low labor standards are not significant explanatory variables for trade patterns and for labor conditions in importing countries, the improvement of labor standards is nevertheless an important objective. The lack of a strong relationship also does not imply that trade agreements will be *a priori* ineffectual and thus should be automatically excluded as a potential tool. The argument that trade agreements should by definition not include anything pertaining to labor standards is increasingly losing force. The WTO, having already incorporated intellectual property rights and environmental issues, indicated that it will ultimately address the labor standards issue in some manner. The appropriate question is what mechanisms are the most effective for the simultaneous attainment of improved labor conditions and global economic integration. Several tools have already been employed: domestic agreements and actions, international agreements, and voluntary market-based solutions.

U.S. Domestic Agreements and Actions

The United States has been at the forefront of efforts to include worker rights conditions in its own trade programs. Currently, U.S. trade programs with such conditions include the Generalized System of Preferences (GSP) program, the Caribbean Basin Initiative (CBI), and the U.S. Overseas Private Investment Corporation (OPIC) program.[7] The labor provisions in most of the U.S. programs are based on those in the GSP program. The most recent trade initiative that includes conditions pertaining to labor standards is the labor side agreement concluded as part of NAFTA.

A comparison of the labor provisions in the GSP program and the NAFTA labor side agreement suggests the following:

- Legislation based on the enforcement of current national laws *with* some mechanism for examining the validity of these laws and their impact in practice may be a viable alternative to attempts at establishing a common or minimum criteria for labor standards.
- Although NAFTA lacks the enforcement mechanisms present in the GSP program with respect to the standards of freedom of association and the right of collective bargaining, the review process is much more rigorous because it is firm specific and thus may have a greater overall impact, especially in the long run.
- Enforcement mechanisms such as sanctions are less likely to be accepted in bilateral or multilateral agreements.

[7] The European Commission (EC) has recently taken a number of steps to include labor standards in its domestic and trade policies. In 1989, the EC established a Social Charter on worker rights that was subsequently incorporated into the Maastricht Treaty. In relation to this, a Commission on Labor Co-operation was established to oversee a broad range of labor conditions. According to the regulations, countries that persistently violate domestic labor laws can be fined and an unpaid fine can be punished by suspension of trade benefits equal to the amount of the fine. The EC also added labor standard conditions to its GSP program in 1994.

International Agreements and Actions

The primary role of improving labor standards in the international context has been and continues to lie with the ILO. Created by the Treaty of Versailles in 1919, the ILO has established over 170 conventions covering many important aspects of worker rights. In addition to promulgating these conventions, the ILO also provides technical assistance and training to member countries. However, the organization views the ratification and monitoring of conventions as a key function. Examination of country performance in the ratification process indicates that active participation is not seen as an essential activity by many of its member countries.

Table 9 presents ratification information by country for several ILO conventions typically identified as representative of fundamental human rights. The information suggests that, although ratification *may* signal progress in that country with respect to the convention, nonratification does not indicate a lack of attention to that standard. Among the industrialized countries, only Germany and France have ratified all four of the conventions. The ratification patterns of the other industrialized countries indicate that several of them have not ratified Convention 138 pertaining to minimum age of employment. Yet all of these countries have fairly stringent child labor laws that are generally well enforced. At the same time, nonratification for some of the countries is truly a reflection of noncompliance. The effectiveness of the ILO could be enhanced if member countries attached greater commitment to the ratification process.

In June of 1994, the ILO Secretariat initiated a comprehensive research program on the integration of social welfare and trade policy. The main impetus for this action was the desire to support ILO objectives with a stronger enforcement mechanism. The ILO document "The Social Dimension of the Liberalization of World Trade," one of the outcomes of the research program, suggested that the ILO should work together with the WTO in overseeing core labor standards. The ILO proposed that core labor standards, defined as freedom of association, the right of collective bargaining and freedom from forced labor, be included as a social clause in the WTO.[8] Complaints and progress would be monitored by the ILO while the WTO would be responsible for the enforcement of core labor standards through sanctions. This proposal has been extensively discussed in ILO working party meetings, and, in early 1995, the ILO decided to remove the idea of sanctions from their mandate because of internal disagreements over this issue.

Although the potential precursor to the GATT, the International Trade Organization (ITO), explicitly linked trade and labor policies, the GATT and the WTO contain very little direct language pertaining to this issue.[9] Attempts by the United States and France to advance labor standards in the WTO have also met with substantial resistance.[10] Reconciliation of disparate views on the role of labor standards in trade policies requires the development of a mutual understanding on the issues discussed above, namely, the impact of trade on labor standards and labor market conditions in both the industrialized and the developing countries, and the most effective means for simultaneously improving labor standards and increasing global economic integration.

This article is adapted from a forthcoming USITC working paper, *International Trade, Labor Standards, and Labor Market Conditions: An Evaluation of the Linkages*. A list of recent working papers, along with ordering instructions, are contained in the Appendix to this issue.

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[8] The organization expressed the desire to include freedom from child labor as a core labor standard, but did not formally advocate it.

[9] The implementing document of the ITO, the Havana Charter, contained the following statement: "The Members recognize that unfair labor conditions, particularly in production for export, create difficulties in international trade and, accordingly, each Member shall take whatever action may be appropriate and feasible to eliminate such conditions within its territory."

[10] See Ted Wilson, "Trade Issues of the 1990s—Part II," USITC, *International Economic Review*, December 1994.

Table 9
Ratification of major ILO Conventions pertaining to core labor standards, by convention numbers

Country	87[1]	98[1]	105[1]	138[1]
U.S.	N[2]	N	Y	N
High Income				
Japan	Y	Y	N	N
Canada	Y	N	Y	N
Germany	Y	Y	Y	Y
United Kingdom	Y	Y	Y	N
France	Y	Y	Y	Y
Singapore	N	Y	X	N
Hong Kong	N	N	N	N
Upper Middle				
Mexico	Y	N	Y	N
Korea	N	N	N	N
Malaysia	N	Y	X	N
Lower Middle				
Thailand	N	N	Y	N
Philippines	Y	Y	Y	N
Low Income				
China	N	N	N	N
Indonesia	N	Y	N	N
India	N	N	N	N

[1] The conventions are as follows:
87: Freedom of association and protection of the right to organize.
98: Right to organize and collective bargaining.
105: Abolition of forced labor.
138: Minimum age.
[2] "N" indicates not ratified, "Y" ratified and "X" indicates that the country has denounced the convention.
Source: International Labour Organization, *Lists of Ratification by Convention and by Country*, 1994.

APPENDIX

Office of Economics Working Papers - List

Office of Economics Working Papers
U.S. International Trade Commission
August, 1995

The following is a list of recent Office of Economics working papers. Copies of papers, and a complete list of working papers which are currently available, can be obtained from the Office of Economics. Please request working papers by reference date/code, title, and author. Address requests to: Office of Economics, U.S. International Trade Commission, 500 E Street SW, Washington DC 20436, USA, or by fax at (202) 205-2340.

Reference Date/Code	Title	Authors
1995:		
95-07-A	Transition to A Market Economy in the Countries of the Central European Free Trade Agreement (Visegrad Group)	*Peter Pogany
95-06-D	After NAFTA: Western Hemisphere Trade Liberalization and Alternative Paths To Integration	*Sandra Rivera
95-06-C	International Trade, Labor Standards & Labor Markets Conditions	*Mita Aggarwal
95-06-B	Economic Policies and Developments in the countries of the Central European Free-Trade Agreement (VISEGRAD GROUP) DURING 1948-1989	*Peter Pogany
95-06-A	China Briefing Paper	*James Tsao and *Janet Whisler
95-04-A	International Trade, Environmental Quality and Public Policy	*Michael J. Ferrantino
95-03-A	Export Diversification and Structural Dynamics in the Growth Process: The Case of Chile	Sheila Amin Gutierrez-de Piñeres and *Michael Ferrantino
1994:		
94-12-C	Regional Trade Arrangements and Global Welfare	*Nancy Benjamin
94-12-B	The General Equilibrium Implications of Fixed Export Costs on Market Structure and Global Welfare	*Michael P. Gallaway
94-11-B	Economic Analysis for Trade and Environment - An Introduction	*Michael J. Ferrantino
94-11-A	A Brief Description of International Institutional Linkages in Trade and Environment	*Michael J. Ferrantino
94-10-B	Explaining Japanese Acquisitions in the United States: The Role of Exchange Rates	*Bruce Blonigen
94-10-A	The Cash Recovery Method and Pharmaceutical Profitability	*Christopher T. Taylor
94-08-A	Towards a Theory of the Biodiversity Treaty	*Michael J. Ferrantino

Reference Date/Code	Title	Authors
94-06-A	Estimating Tariff Equivalents of Nontariff Barriers	*Linda A. Linkins and *Hugh M. Arce
1993:		
93-11-B	Infant Industry Protection with Oligopoly and Learning-by-Doing	*Theodore To
93-11-A	A Computable General Equilibrium Estimation of the Effects of the U.S. Meat Program	*Gerald Berg Kenneth A. Reiert
93-08-B	Export Subsidies and Oligopoly with Switching Costs	*Theodore To
93-08-A	Tariffs, Rent Extraction and Manipulation of Competition	*Theodore To
93-07-A	A General Equilibrium Analysis of North American Economic Integration	David W. Roland-Holst *Kenneth A. Reinert *Clinton R. Shiells
93-06-B	AGE Models of North American Free Trade: An Introduction	*Joseph F. Francois *Clinton R. Shiells
93-06-A	Trade Policy and Employment in General Equilibrium	Karen E. Thierfelder *Clinton R. Shiells
93-04-A	Linking Trade and Growth: Insights from the New Growth Theories	*Joseph F. Francois *Clinton R. Shiells
93-03-A	Scale Neutrality, Process Innovation, and Growth	*Joseph F. Francois *Clinton R. Shiells

Source: * Staff Economist, U.S. International Trade Commission.

STATISTICAL TABLES

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Indexes of industrial production, by selected countries and by specified periods, Jan. 1991-May 1995
(Total industrial production, 1991=100)

Country	1992	1993	1994	1994 I	1994 II	1994 III	1994 IV	1994 Dec.	1995 I	1995 Jan.	1995 Feb.	1995 Mar.	1995 Apr.	1995 May
United States[1]	107.6	112.0	118.1	115.7	117.4	118.8	120.4	121.7	122.1	122.0	122.1	121.9	121.2	120.9
Japan	96.0	92.0	93.1	91.2	91.8	94.1	94.0	95.6	([2])	([2])	([2])	([2])	([2])	([2])
Canada[3]	98.8	101.4	107.9	103.7	106.9	109.4	111.7	112.9	([2])	([2])	([2])	([2])	([2])	([2])
Germany	101.0	93.5	96.6	93.6	96.4	97.6	99.2	100.7	([2])	([2])	([2])	([2])	([2])	([2])
United Kingdom	96.0	98.0	103.1	100.6	102.7	104.1	107.7	104.7	([2])	([2])	([2])	([2])	([2])	([2])
France	98.9	95.3	([2])	95.9	98.6	99.7	([2])	103.2	([2])	([2])	([2])	([2])	([2])	([2])
Italy	97.8	95.7	102.2	94.7	100.7	103.7	104.5	107.7	([2])	([2])	([2])	([2])	([2])	([2])

[1] 1987=100
[2] Not available.
[3] Real domestic product in industry at factor cost and 1986 prices.

Source: *Main Economic Indicators;* Organization for Economic Cooperation and Development, March 1995, *Federal Reserve Statistical Release;* June 15, 1995.

Consumer prices, by selected countries and by specified periods, Jan. 1992-May 1995
(Percentage change from same period of previous year)

Country	1992	1993	1994	1994 II	1994 III	1994 IV	1994 Oct.	1994 Nov.	1994 Dec.	1995 I	1995 Jan.	1995 Feb.	1995 Mar.	1995 Apr.	1995 May
United States	3.0	3.0	2.6	2.4	2.9	2.7	2.6	2.7	2.7	2.8	2.8	2.9	2.9	3.1	3.2
Japan	1.6	1.3	0.7	0.7	0.0	0.8	0.7	1.0	0.7	0.1	0.6	0.2	-0.4	-0.2	([1])
Canada	1.5	1.8	0.2	0.0	0.2	0.0	-0.2	-0.1	0.2	1.6	0.6	1.8	2.2	2.5	2.9
Germany	4.0	4.2	3.0	3.0	3.0	2.8	2.8	2.7	2.7	2.3	2.3	2.4	2.3	2.3	2.2
United Kingdom	3.7	1.6	2.5	2.6	2.3	2.6	2.4	2.6	2.9	3.4	3.3	3.4	3.5	3.3	3.4
France	2.4	2.0	1.7	1.7	3.8	1.6	1.6	1.6	1.6	1.7	1.7	1.7	1.8	1.6	1.6
Italy	5.1	4.4	1.0	3.9	3.8	4.0	3.8	3.9	4.2	54.4	4.0	4.5	4.9	5.2	5.4

[1] Not available.

Source: *Consumer Price Indexes, Nine Countries*, U.S. Department of Labor, July 1995.

Unemployment rates, (civilian labor force basis)[1] by selected countries and by specified periods, Jan. 1992-May 1995

Country	1992	1993	1994	1994 II	1994 III	1994 IV	1994 Nov.	1994 Dec.	1995 I	1995 Jan.	1995 Feb.	1995 Mar.	1995 Apr.	1995 May
United States	7.4	6.8	6.1	6.2	6.0	5.6	5.6	5.4	5.5	5.7	5.4	5.5	5.8	5.7
Japan	2.2	2.5	2.9	2.9	3.0	3.0	2.9	3.0	3.0	2.9	3.0	3.0	3.0	([2])
Canada	11.3	11.2	10.3	10.7	10.2	9.7	9.6	9.6	9.7	9.7	9.6	9.7	9.4	9.5
Germany	4.6	5.8	6.5	6.5	6.5	6.5	6.4	6.4	6.4	6.4	6.4	6.5	6.5	([2])
United Kingdom	10.0	10.4	9.5	9.7	9.6	9.0	9.0	8.8	8.7	8.8	8.7	8.7	8.6	8.6
France	10.2	11.3	12.3	12.4	12.4	12.3	12.3	12.3	12.1	12.2	12.1	12.1	12.0	([2])
Italy	7.3	10.3	11.4	11.9	11.4	12.0	([3])	([3])	12.2	12.2	([3])	([3])	12.2	([3])

[1] Seasonally adjusted; rates of foreign countries adjusted to be comparable with the U.S. rate.
[2] Not available.
[3] Italian unemployment surveys are conducted only once a quarter, in the first month of the quarter.

Source: *Unemployment Rates in Nine Countries*, U.S. Department of Labor, July 1995.

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Money-market interest rates,[1] by selected countries and by specified periods, Jan. 1992-June 1995
(Percentage, annual rates)

				1994				1995							
Country	1992	1993	1994	II	III	IV	Dec.	I	II	Jan.	Feb.	Mar.	Apr.	May	Jun.
United States	3.7	3.2	4.6	4.3	4.8	5.8	6.2	6.2	6.0	6.2	6.2	6.1	6.1	6.0	5.9
Japan	4.4	2.9	2.2	2.1	2.2	2.3	2.3	2.2	([2])	2.3	2.3	2.1	1.5	1.3	([2])
Canada	6.7	5.1	5.5	5.7	5.8	5.9	6.7	8.1	([2])	7.8	8.4	8.3	8.1	7.5	([2])
Germany	9.4	7.1	4.0	5.1	4.8	5.1	5.2	4.9	([2])	5.0	5.0	4.9	4.5	4.4	([2])
United Kingdom	9.5	5.8	5.4	5.1	5.3	6.0	6.3	6.6	([2])	6.5	6.7	6.6	6.6	6.6	([2])
France	10.1	8.3	5.7	5.5	5.5	5.5	5.8	5.7	([2])	5.7	5.7	7.7	7.6	7.2	([2])
Italy	13.9	10.0	8.4	7.9	8.5	8.8	8.9	9.7	([2])	9.1	9.1	10.9	10.9	10.3	([2])

[1] 90-day certificate of deposit.
[2] Not available.

Source: *Federal Reserve Statistical Release*, July 10, 1995 *Federal Reserve Bulletin*, July 1995.

Effective exchange rates of the U.S. dollar, by specified periods, Jan. 1992-June 1995
(Percentage change from previous period)

				1994			1995						
Item	1992	1993	1994	II	III	IV	I	II	Feb.	Mar.	Apr.	May	Jun.
Unadjusted:													
Index[1]	97.0	100.1	98.5	100.0	96.5	95.9	96.0	89.7	96.0	92.4	89.3	89.9	89.8
Percentage change	-1.5	3.1	-1.6	-1.6	-3.5	-.6	.1	-7.0	-1.0	-3.6	-3.3	.6	-.1
Adjusted: Index[1]	100.9	104.2	101.5	103.5	99.9	98.0	95.1	90.8	96.8	92.9	90.5	91.0	90.9
Percentage change	-.1	3.3	-2.7	-1.2	-3.6	-1.9	-2.9	-5.1	-1.6	-3.9	-2.6	.5	-.1

[1] 1990 average=100.

Note.—The foreign-currency value of the U.S. dollar is a trade-weighted average in terms of the currencies of 18 other major nations. The inflation-adjusted measure shows the change in the dollar's value after adjusting for the inflation rates in the United States and in other nations; thus, a decline in this measure suggests an increase in U.S. price competitiveness.

Source: Morgan Guaranty Trust Co. of New York, July 1995.

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Merchandise trade balances, by selected countries and by specified periods, Jan. 1992-March 1995
(In billions of U.S. dollars, Exports less Imports (f.o.b - c.i.f), at an annual rate)

				1994			1995				
Country	1992	1993	1994	II	III	IV	I	Feb.	Mar.	Apr.	May
United States[1]	-84.5	-115.7	-151.3	-152.4	-164.5	-157.1	-167.5	-162.0	-156.2	-179.4	-174.2
Japan	106.4	120.3	([2])	121.9	113.5	([2])	([2])	([2])	([2])	([2])	([2])
Canada[3]	12.1	13.3	18.0	13.5	20.1	24.7	([2])	([2])	([2])	([2])	([2])
Germany	21.0	35.8	45.6	51.7	40.2	55.2	([2])	([2])	([2])	([2])	([2])
United Kingdom	-30.8	-25.5	([2])	-21.4	-15.3	([2])	([2])	([2])	([2])	([2])	([2])
France[3]	5.8	15.8	15.8	14.8	15.6	23.0	([2])	([2])	([2])	([2])	([2])
Italy	-6.6	20.6	([2])	21.6	27.6	([2])	([2])	([2])	([2])	([2])	([2])

[1] Figures are adjusted to reflect change in U.S. Department of Commerce reporting of imports at customs value, seasonally adjusted, rather than c.i.f. value.
[2] Not available.
[3] Imports are f.o.b.

Source: *Advance Report on U.S. Merchandise Trade*, U.S. Department of Commerce July 18, 1995; *Main Economic Indicators;* Organization for Economic Cooperation and Development, March 1995.

U.S. trade balance,[1] by major commodity categories and by specified periods, Jan. 1992-May 1995
(In billions of dollars)

				1994		1995					
Country	1992	1993	1994	III	IV	I	Jan.	Feb.	Mar.	Apr.	May
Commodity categories:											
Agriculture	18.6	17.8	19.0	3.8	6.9	6.2	1.9	2.2	2.1	1.9	1.6
Petroleum and selected product—(unadjusted)	-43.9	-45.7	-47.5	-14.0	-11.5	-11.6	-3.8	-3.5	-4.3	-3.9	-4.5
Manufactured goods	-86.7	-115.3	-155.7	-44.3	-47.5	-40.3	-15.0	-12.3	-13.0	-13.6	-14.1
Selected countries:											
Western Europe	6.2	-1.4	-12.5	-5.4	-3.6	-.1	.1	-.5	.3	-.4	-.9
Canada	-7.9	-10.2	-14.5	-3.7	-4.8	-2.4	-1.0	-.9	-.5	-1.5	-1.1
Japan	-49.4	-59.9	-65.6	-16.8	-18.2	-15.0	-4.6	-4.6	-5.8	-5.8	-5.4
OPEC (unadjusted)	-11.2	-11.6	-13.8	-4.8	-3.2	-1.6	-.3	-.7	-.6	-1.2	-1.3
Unit value of U.S.imports of petroleum and selected products (unadjusted)	$16.80	$15.13	$14.22	$15.70	$14.95	$15.43	$15.05	$15.50	$15.76	$16.71	$17.39

[1] Exports, f.a.s. value, unadjusted. Imports, customs value, unadjusted.

Source: *Advance Report on U.S. Merchandise Trade*, U.S. Department of Commerce, July 18, 1995.

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